

**Study of the Taxation of Electronically Delivered Products**  
**Committee Meeting Minutes**  
**November 15, 2007**

**1. Welcome**

- Chair Hunter opened the meeting.
- Present: Chair Ross Hunter, Vice-Chair Joseph Zarelli, Rep. Ed Orcutt, Director Cindi Holmstrom, Rich Prem, Bruce Reid, Steve Collier, Jim Justin, Ron Bueing, and Paula Bohauer.
- Absent: Sen. Derek Kilmer, Ben Kim, Greg Silverman, Julie Murray, Victor Moore, and Chuck Robinson.
- Present via phone: No members participated via phone.

**2. Review and Approve Minutes for 10/2 and 10/22 Meetings**

- Motion by Ron Bueing to strike sentence on page 7, 4<sup>th</sup> bullet up, asked to strike “believes that the current statute is adequate with respect to digital goods.” He meant to say something else. Minutes amended.
- Motion made and carried approving the minutes for October 2, and October 22, 2007.

**3. Presentation on Other Jurisdictions: US, Canada, and European Union (EU)**

*Dylan Waits, Tax Policy Specialist with the Department of Revenue (DOR), was asked to present an overview of how the US, Canada, Iceland, and the EU treat digital goods. Mr. Waits explained that while he found information about data servers in Iceland, he was unable to locate tax information. Mr. Waits presented a handout to the committee.*

- **European Union (EU)**

- (04:27) The EU members’ consumption tax is a value-added tax of between 15 and 25 percent –each country sets its own rate. EU defines digital goods as supplies of services rather than as goods. Mr. Waits provided examples of electronically delivered supplies, such as web sites; web hosting; software; database access; on-line subscriptions; music, books, and games – both downloaded and streamed; remote education/classes; advertising service; and banking and brokerage.
- (05:52) Question about on-line banking and brokerage services. Member asked if VAT applies only if there is a specific charge for the service. Yes.
- (07:09) member question about on-line subscription service and sourcing of fee. Mr. Waits responded that it depends on whether company is an EU company or a non-EU company. A non-EU company would charge VAT based on the destination.
- (08:20) Rich Prem said destination would be customer’s residence. EU has a “use and enjoyment” concept. If service is delivered from outside the EU, the customer’s residence is default. Example of a UK resident who dials into their gaming subscription from Hong Kong, the non-EU company is supposed to source to the customer’s UK residence. If the company is an EU company, then it is sourced to the company’s location. Another example of London-headquartered company moving to the US where the sourcing would be to the

UK customer's residence. If company moves to France, would source to its French location and charge the VAT for France.

- (10:58) Chair Hunter rephrased as sourcing for companies within the EU is origin based. He asked whether the origin is the company's location or the server's. Mr. Prem said it's where the company is located based on preponderance – where most of costs are incurred. "Place of establishment" is not related to servers. It's more to headquarters or the in-community office.
- (10:56) Mr. Waits noted that an important aspect is that the EU does not delineate between goods or services. The definitions do, but the tax consequences do not. Either way it's defined, as a product or service, it's still subject to VAT. The difference is in how it's sourced.
- (11:28) Mr. Prem provided some background with respect to the EU's logic. If a company is selling a physical good, it would be caught at the border when it comes into the country and customs will be there to clear the goods. From an Amazon perspective, if a customer purchases a CD they can't get in Europe, Amazon doesn't collect the VAT, but the delivery services will pay the tax to clear customs and then charge it to the customer when the customer gets the goods. With an electronic version, there is no customs/gate. The EU knew they could never collect the tax from the buyer so wanted to still hold the seller liable for the VAT. The easiest way to do that was to call it a service and under the use/enjoyment concept. Mr. Prem noted an interesting point from a tax policy perspective is that the EU didn't want to have community sellers having to collect based on destination – there would have been a hue and cry and it would have been expensive for EU sellers to do so. The EU still wanted to collect the VAT on sales from US sellers because they viewed that as competition. The EU created a double-standard for those sellers within the EU and those selling from outside the EU. Mr. Prem explained that this has been a bone of contention because of the greater burdens placed on people selling from outside the EU that people selling from within the EU.
- (15:26) Paula Borhauer asked about consumer residence and how it's identified. Mr. Prem answered that there was a debate about this and the potential for evasion. The EU settled on that a seller can rely on the customer's declaration or other information that doesn't have to be verified, such as a credit card billing address. Most companies use the credit card billing address as a proxy to identify the residence.
- **Canada**
  - (17:28) Mr. Waits explained that Canada is somewhat similar, but their definition is somewhat more complicated. Canada does not consider digitally delivered products to be tangible personal property. Canada has characterized digitally delivered products as intangible personal property and services. Intangible personal property ranges from copy rights, royalties, rights of a temporary nature (i.e., streaming), digital movies, canned software, anything that's downloaded, rights to access or use digitized goods, music, images, books, etc. Services include customized software. Canada subjects goods and services to their GST.

The key difference is how involved a human being is. The result of someone's work is a service even if it will be delivered electronically.

- Canada has in addition to the GST, the provincial sales tax, and then the move for the harmonized sales tax. A member asked a question about the rates imposed. Mr. Waits used Ontario as an example – 5% as the provincial rate and 6% federal.
- Although Canada distinguishes between intangible property and services, both are subject to the GST.
  - (22:46) Rich Prem clarified that it is important to note that the Canadian system and the EU system – the tax is only borne by the ultimate consumer. Example used of Amazon purchasing a digital item for \$100, it pays 6 percent and then sells it to Rep. Hunter for \$150. Amazon would collect 9% tax from Rep. Hunter, but would only pay 3% to the government because it would take an input credit. Both the Canadian and EU system is that business is outside the loop of paying tax. Allowing a company to recover its input taxes helps exports. Mr. Prem noted that both Canada and the EU have designed the tax systems so that a) the tax is borne by the ultimate consumer and there is no business tax, and, b) to help the export economy.
- (26:01) Sourcing is based on the destination when it's coming from outside Canada and origin based when coming from inside.
  - (26:45) Rich Prem noted that from one province to another, sourcing is based on destination. Amazon looks to the credit card billing address.
  - (27:07) A member commented about what he believes is a difference between the VAT and Washington's retail sales/use tax system in the context of self-created/constructed assets. He noted that with VAT, you pay tax as you purchase items and ultimately get a credit for what you paid when you sell. Under the sales tax, you pay tax if you build a machine that isn't used in an exempt manner, as he would pay tax on it. He asked Mr. Waits to confirm that this is a significant difference between the VAT and the sales tax. Construction of a computer used to further illustrate. Under Washington's system, he would have to establish a value and pay tax for a computer he assembled with parts and his labor. Under a VAT system, he may have incurred some VAT on components but he doesn't incur the equivalent of a use tax on his labor and he wouldn't be allowed a credit for VAT against ultimate sales. This was confirmed.
- **United States.**
  - (29:30) Mr. Waits noted that the most on-point information he found was with respect to cell phones and that there are likely discrepancies that have to be taken into account. This is important because the study addressed games, ring tones, music, pictures, and other information downloaded to cell phones. The results:
    - 5 states do not impose a sales or use tax of any kind.
    - 21 states imposes a sales and use tax on downloads to cell phones. This is a little complicated because it appears that some states apply telecommunications taxes differently than to other purchases.
    - (31:00) Chair Hunter asked if this means that downloading a game to his cell phone might be taxed differently than downloading a game to his

- computer. Mr. Waits replied that this is possible – the study didn't go into that much detail. Discussion about how seller would know location.
- 4 states do not impose a sales/use tax on cell phone-related transactions but they may impose sales tax on same downloads to other places.
  - Remaining 20 states do not charges sales/use tax on any of these downloads.
  - 4 states treatment of electronically delivered products:
    - New York treats as intangible personal property – not subject to tax.
    - Tennessee treats digital transmissions of anything other than software as intangible personal property that is not subject to tax.
    - Alabama treats downloads as tangible personal property. An administrative action held that downloads of digital photos are tangible personal property.
    - Utah holds that downloaded music is tangible personal property subject to tax.
    - Chair Hunter summarized the difference as being do they tax it at all and if so, do they have a specific tax versus including it as tangible personal property.
  - Mr. Waits explained that it appears that some states define downloads as intangible personal property in order to subject income to income tax.
    - (36:53) Ron Bueing was not sure of point being made by Mr. Waits. Mr. Waits responded that like with the EU and Canada, there are broader tax issues being considered. For states with an income tax, when defining transactions as intangible personal property is that they may be considering taking the transaction out of the sales tax world may bring the transaction into the income tax world. Mr. Bueing disagreed – he thinks that as intangible personal property, they may be giving up the income tax because of a lack of presence. He thinks that states would rather have it as tangible personal property to tax both for sales tax and income tax.
  - (39:13) Streamlined Sales and Use Tax Agreement 2001 Survey of participating states
    - 9 states tax digitized goods – 6 on the theory that digitized goods are tangible personal property.
    - 14 states do not tax digitized goods – 9 on the theory that digitized goods are not tangible personal property.
    - Study/survey was not completed – led into published survey on treatment of prewritten software.
      - (40:33) Bruce Reid believes this is inaccurate reflection of what states were doing at the time. People responding for the various states were not in the right position of authority to understand what their state's position was. He expressed concern about giving authority to this study and believes that if information is to become a part of the record, it should be footnoted. Chair Hunter indicated that this would be done. (Refer to discussion at 02:26:53.)
    - (41:22) Most recent definition that Streamlined has made of digital goods.
      - Under streamlined, digital/audio/visual works, digital/audio works, and digital books are not tangible personal property. Any other digital products are not tangible personal property as of 2010.
      - (42:11) Noting that because DOR is a member and has to follow the streamlined rules, Ron Bueing asked if it was a safe statement

to say that DOR is in compliance and that therefore does not treat these enumerated items as tangible personal property for Department of Revenue purposes? That would mean that as of January 1, 2008, we would be out of compliance with streamlined if they are treated as tangible personal property.

- (42:49) Director Cindi Holmstrom explained that the state has two years for the state to amend the tax laws to be in compliance for the definition of the three items and two years beyond 2010 to amend laws for all other digital products. If the State and policy makers choose to tax the other digital products, there will have to be some other statute to tax those products other than tangible personal property. Mr. Bueing asked if this was a waiver from the regular rules. Director Holmstrom explained that generally the streamlined rules allow states two years to change laws to be compliant with changes to the agreement. She further explained that states have to work things through and need time to change their laws through the legislative process.
- (45:21) A member wanted to talk about the VAT and how it's relevant to what we're doing. He noted he had noticed that the VAT reaches out to tax services and asked if Mr. Waits if there were states that attempted to do the same. Mr. Waits responded no.

#### **4. Discussion on Current Law Statements**

- (46:06) Chair Hunter noted that there are two current law statements. The committee's purpose is to resolve the differing interpretations of current law and that it should be pointed out to the Legislature that there are differing interpretations. The intent is to have both in the record and in the report to the Legislature. Dylan Waits (DOR staff) led the discussion.
- Mr. Waits explained that DOR of Revenue's statement of current law is based on the decision tree presented at the previous meeting. Chair Hunter clarified that this is how digital goods are currently subject to tax – in effect the law.
- (48:05) The statement:
  - Sets up a brief description of what taxes may apply to the delivery of electronic goods;
  - Discusses sales of a service;
  - Discusses sales of products; and
  - Describes other views.
- (49:46) Gil Brewer (DOR's Legislative Liaison) explained that this the statement is in the narrative description of what the members received graphically as the decision tree handed out at the last minute. DOR assumed both would be included in the preliminary report.
- Mr. Brewer also explained for the record that the second statement for the business community has Ron Bueing's name on it. Mr. Brewer was asked to change this to Association of Washington Business (AWB) because Mr. Bueing is representing business community and they have a broader

viewpoint. Mr. Brewer left on vacation before the request was further relayed to staff. Chair Hunter commented that because there are others also representing the business community, he agreed that it was appropriate to change it to AWB's interpretation. (Change made.)

- (51:18) Steve Collier commented about information services and standard information. He noted that this was proposed during DOR's rulemaking the previous year and is not accepted by the business community. It's new administrative rule and taxpayers have not had a chance to combat it in the courts. Mr. Collier stated his belief that this is why the committee is there. Chair Hunter stated that there are broader reasons than that but that it is one of them. Director Holmstrom responded that it has been a long-standing principle based on the 1985 rule. For clarification, Chair Hunter asked Mr. Collier to "walk him through" his concern again. Mr. Collier is concerned about the statement: "The term 'information services' does not include standard information that is delivered or made available through any means, such as through a tangible storage medium or an electronic download." In Safeco's case, sales tax applies to driving record information, particularly if downloaded. There are numerous questions because if the information were customized specifically for you it would be a service and not subject to sales tax. Mr. Collier questioned use tax would apply if it was subsequently used by a sub or an affiliate. He noted that the rule does not address use tax and other information issues related to use tax. Mr. Collier noted that it's called law, but believes it is developing law. Chair Hunter rephrased as Mr. Collier not questioning the exemption for standard information, rather Mr. Collier is questioning the taxable treatment of information services. Mr. Collier confirmed.
- (54:46) Ron Bueing echoed Mr. Collier's comments. He used the purchase of a mailing list of names and addresses to show inconsistency. Based on a DOR determination, mailing lists are not subject to sales tax. Mailing lists are standard information and this is contrary to what's been presented. He stated that this is an evolution beyond where many believed the law has been.
- (56:39) Jan Bianchi (Assistant Director of DOR's Interpretation & Technical Advice Division) came forward to explain that the facts in the determination Mr. Bueing referred to was that the mailing list was specifically customized for the individual taxpayer. Mr. Bueing stated that he was talking about standard information.
- (57:17) Steve Collier clarified that his concern is about standard information. He noted that standard information was meant by DOR to be included as taxable in the proposed rule. Many taxpayers were concerned about this. Mr. Collier noted that the financial services industry was able to carve out an exemption for standard financial information. He further noted that this is not defined elsewhere in the statute. This is the concern of Safeco and many other services that were not included in the new bill.
- (58:02) Senator Zarelli commented that the committee would never get to the point of defining what policy should be if they keep discussing what DOR currently views as the law. He agrees that outside this body, a taxpayer has a

right to challenge the interpretation. He expressed a belief that nobody believes that what is stated by committee establishes a precedent. Chair Hunter noted that he finds where people differ as interesting. Mr. Bueing stated that in order to make the changes in the law, they need to understand how they get there through the law.

- (01:00) Ron. Bueing explained AWB's perspective of current law.
  - Mr. Bueing noted that RCW 82.04.050 is the only place in the statute that defines a retail sale. He noted that the definition includes sales of tangible personal property and specifically enumerated items.
  - The question is where digital goods fit in. Mr. Bueing noted that there is no specifically enumerated category for sales of digital goods.
  - For purposes of the discussion, digital goods means electronically delivered.
  - Electronically delivered goods are not tangible personal property. There is no digital equivalency test. Items that are in digital form, such as music downloads, movies, books, etc., may or may not be prewritten computer software, but they do not believe such items to be tangible personal property. CDs, DVDs, books, tapes are examples of tangible personal property.
- (01:02:21) They also believe that information is not tangible personal property. Information services are not enumerated in the statute as a retail sale and it's not tangible personal property – therefore it is not a retail sale.
- Downloaded music is different than records/CDs. Just because someone is using a substitute for a prior product doesn't mean it has to be taxed.
- They believe that each product should be looked at individually as it comes to determine what the taxability should be up instead of using a digital equivalency test or something similar.
- (01:04:38) Jim Justin made an inaudible comment.
- (01:05:11) Rep. Orcutt asked what the purpose of the discussion is – to change DOR's interpretation from this point forward or to put it into the preliminary report to the Legislature. Chair Hunter explained the intent to show that there are differences of opinion and to include that in the report to summarize for the Legislature what the problems are.
- (01:07:11) Director Holmstrom asked the committee whether DOR's discussion about other's interpretation (last paragraph) of Department's summary should remain or be replaced by AWB.
  - (01:08:22) Steve Collier replied that Ron Bueing's statement is more striking as to how far apart DOR and the business community are while DOR's paragraph is cursory.
  - (01:08:32) Committee Bruce Reid expressed concern about Ron Bueing's statement morphing into the AWB's statement. There was no invitation to the broader industry group (AEA or Washington Software Alliance) to submit their views. He's not sure that AWB's statement is reflective of a broader set of interest groups. Asked the committee to invite other interest groups to submit their views and to also include their views. Mr. Reid was unaware that AWB was going to put this forward.

- (01:10:06) Amber Carter from the AWB noted that this had been widely discussed by their Tax and Fiscal Policy Council, but agrees that other industry groups should have an opportunity for input.
- (01:11:16) Chair Hunter expressed concern about the need to have the report approved during the meeting. He's interested in other views, but doesn't know how the committee can include something it doesn't have. During the ensuing discussion between Chair Hunter, Rep. Orcutt, and Bruce Reid, it was resolved to alter DOR's paragraph to state that there are other views as to current law, the AWB interpretation is one, and other perspectives may be included in the final report. (Refer to discussion concerning the Preliminary Report to the Legislature at 01:55:45.)

**5. Review and Approve: Problem Statement, Goals and Workload Draft**

- (01:12:47) Chair Hunter and Gil Brewer noted that only comment received was from Jim Justin, which were incorporated.
- (01:15:08) Mr. Justin asked that Problem Statement number four be changed to clarify that there is also an impact on local government. (Change made.)
- (01:17:38) Member Steve Collier asked about the context of the word "content" in Vision and Goals Statement number three. Gil Brewer noted that this was a change requested by Chuck Robinson, was not present for the meeting. (01:18:41) Rich Prem noted his understanding that Mr. Robinson was getting to the point that a printed book is not is not a tangible thing – the purchase isn't a stack of paper and binding, it's one of the content. Mr. Prem stated that Mr. Robinson wanted neutrality regardless of how the content is delivered – the medium, i.e. paper vs. digital, etc.
- (01:19:25) Discussion between Steve Collier, Gil Brewer, and Chair Hunter, with respect to Problem Statement 1, about whether or not current law provides specificity. Mr. Collier suggested change and there was discussion between him and Chair Hunter about whether suggestion was redundant given lead in sentence. No change.
- (01:21:48) Rich Prem asked that statement about potential for class action suits filed by consumers against retailers be included in the problem statement. Rep. Orcutt suggested language, which was incorporated.
- (01:28:20) Director Holmstrom moved to accept the document as amended. Motion seconded and approved.

**6. Break (01:28:58)**

**7. Review and Approve Preliminary Report to the Legislature**

- (01:45:50) Chair Hunter concerned that Department's statement of current law includes a decision tree while AWB's does not. Ron Bueing distributed decision tree to the members and forwarded an electronic version to staff.
- (01:47:45) Director Holmstrom and Rich Prem had a discussion about whether decision tree poses a risk with respect to class action law suits on consumers' behalf. Decision was to make sure the decision tree is clearly labeled as AWB's.
- (01:51:04) Drew Shirk (Department of Revenue staff) presented preliminary report. Mr. Shirk noted that staff used style/format of JLARC reports for preliminary report.



- A review of the statutory enactment through the budgetary provision.
- Index that outlines the subsections.
- Legislative Background of study, committee, and representation. An explanation was added about terminology to tie together the different terms used.
  - (01:52:50) Rep. Orcutt requested the inclusion of language indicating that the terms may be determined to have different means in the future. Jan Bianchi (DOR staff) clarified that terms may have different means for the future, not retrospectively. Language was included.
- Problem Statement as approved earlier in the meeting.
- Vision and Goals Statement as approved earlier.
- Department of Revenue Interpretation of Current Law
  - (01:55:47) New language concerning Other Interpretation of Current Law read to members (Refer to previous at 01:07:11 through 01:11:16.). Chair Hunter noted his approval of language.
  - (01:56:33) Bruce Reid initiated discussion about whether it was appropriate to include discussion of ESHB 1981, enacted during the 2007 session. Mr. Reid expressed belief that bill is reason for committee. Chair Hunter noted that bill was one of many reasons for committee. The bill was one narrowly carved exemption that did pass. Mr. Bueing noted that inclusion is misleading. Director Homstrom indicated that she believes that this is important and should remain. Steve Collier explained that those who did not receive benefit of the carve out became concerned that by including definition of “standard financial information,” that had never been in statute before, by inference the others would be taxed. Concern is with the use of the legislation to buttress DOR’s position. Director Holmstrom noted her belief it is appropriate to include discussion about ESHB 1981 because this is a statement of current law and the bill was enacted last year and changed current law. Mr. Collier made suggestion to alter the language. Chair Hunter prefers that DOR not modify AWB’s statement and that the business community not modify DOR’s statement. Bruce Reid suggested modifying the AWB statement to address ESHB and make an opposing statement. This approach was agreed to. (Refer to discussion at 02:35:44.)
  - (02:03:30) A member asked that second paragraph of page one be altered to read “. . . recognizes that the taxation of ther types of electronically delivered products, *including standard financial information*, remains a policy question.” Director Holmstrom noted her belief that the language was pulled from the statute. Steve Collier read from the first paragraph that ESBH “enacted a sales and use tax exemption for sales of electronically delivered standard financial information to investment management or financial institutions.” A member wants to make it clear that because the bill did that, it didn’t make it that other standard financial information was settled and will now only look at other types of digital information. Language added.
  - (02:06:01) Bruce Reid asked if subtitle on the first page should read “Why study the alternatives to taxation of electronically delivered products?” He also suggested making a similar change to the last sentence in the second

- paragraph. Chair Hunter disagreed, that studying the alternatives to taxation is too limiting. Director Holmstrom read the statute. No change.
- (02:10:17) Rep. Orcutt noted that the subtitle for section 4 reads “. . . State of Current Law, while further on, language refers to “interpretation. He suggested using the same terms. He made the same suggestion for the AWB’s statement. Changes made as suggested.
  - Further change made on page one to refer to “electronically” delivered rather than “digitally” delivered.
  - (02:12:11) Association of Washington Businesses’ Interpretation of Current Law.
    - For easy of reading, Chair Hunter asked that each new section be paginated to begin at the top of the page and use a consistent font size for the header level.
  - Tax Treatment by Other Jurisdictions
    - (02:13:08) Chair Hunter said he would have liked to have seen sourcing included. Determined that it would be too difficult to add at that point.
  - Future Objectives and Work Plan
    - (02:15:46) A member suggested the language “and/or” conveys a different meanings. Chair Hunter noted no need to include the “and/or” because terms were earlier defined to be synonyms. Change was made.
    - (02:17:16) Rich Prem noted that since the last meeting, Congress has passed, and the President has signed the Internet Tax Freedom Act. He’d like to add statement about the impact of the federal act on digital bundles. Language added to the Objectives and Work Plan.

## 7. **2008 Work Plan and Meeting Schedule**

- (02:20:46) Proposed meeting every third Thursday starting in April, except for June.
- Chair Hunter prefers to leave the meeting times flexible.
- (02:23:12) Rep. Orcutt asked that committee meetings be coordinated with forecast council committee meetings. It was agreed to meet on June 19<sup>th</sup> at 11:00.
- (02:24:32) Ron Bueing asked that the May 22<sup>nd</sup> date be changed to later in the month because AWB has a meeting already scheduled in Spokane. Director Holmstrom to choose a couple of dates and to see which works best for committee before finalizing.
- (02:26:53) Dylan Waits (DOR staff) asked if there was still a desire to make a statement about the Streamlined Sales and Use Tax Agreement 2001 Survey of Participating States (Refer to discussion at 39:13 through 40:33). Footnote added.
- A member asked if Preliminary Report would be circulated to members before being presented to the Legislature. Chair Hunter responded yes, but that only technical changes could be made. He does not want to make substantive changes without the committee’s agreement.
  - Jim Justin noted that presentation of the report is on the Finance Committee’s next agenda. Further discussion about panel presenting the report.
- (02:35:44) Rebuttal language with respect to ESHB 1981 added to AWB Interpretation of Current Law. (See discussion at 01:56:33.)
- Motion made, seconded, and approved to accept Preliminary Report.

**8. Public Comment**

- No one present wishing to make public comment.
- Chair Hunter identified those who signed in for the meeting – Bob Longman from Frank Russell Investment Co., Mike Howisey from Moss Adams, LLC, Terry Byington from American Electronics Assn., Amber Carter from AWB, and Mike Bernard from Mason Cook.
- (02:40:51) Meeting adjourned.

*The November 15, 2007, meeting minutes were approved without amendments during the April 24, 2008, meeting.*